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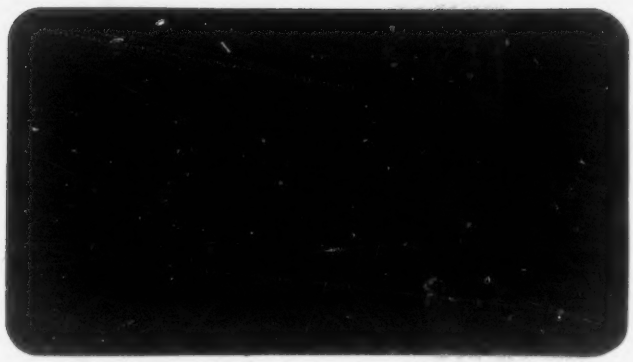

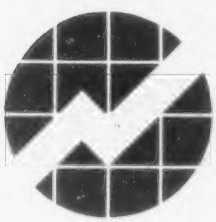

KENT ECONOMIC AND DEVELOPMENT INSTITUTE

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KEDI ECONOMIC SURVEY

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September 30, 1980

President: Vladimir J. Simunek

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Editor: Diane L. Lewis

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1.0 OVERVIEW AND ASSUMPTIONS

1.0 OVERVIEW

Most economists still were seeing the third quarter as one of decline in September. A few were acknowledging that the economy seemed to be doing better than they had figured it would. After mid-September, Courtenay Slater, Commerce Department chief economist, said that in July or August there was a turn around and that recovery had begun. She indicated that as a guess, there would be a small amount of growth in real GNP this quarter.

The forecast by this Institute for the rest of 1980 remains basically unchanged. For the past several months this year has been forecast here as being, on the average, essentially even with the prior year. The performance of the economy during the third quarter is confirming the outlook held by KEDI. There has been improvement in this quarter -- not decline. For the rest of this year, KEDI expects a bit of growth with no drastic ups or downs.

The general forecast by KEDI for 1981 and the following years is maintained: slow growth next year with acceleration in 1982 and 1983, a slowdown in 1984 and renewed growth during 1985. The view here of the inflation rate also remains unchanged; namely, inflation at a rate slightly above 10 percent a year for the entire 1981-85 span.

Typical of many economist or business news writers is the view that the

negative needs emphasis. News of any growth is viewed with great suspicion. Views such as the following reflect this. "The recession may be over, but the recovery will be very, very sluggish." So do writings that say if the recession did end in July, it would be the shortest one ever. Exploring historical precedents for interrupted recessions also fall in this category. The implication is the good news is some kind of fluke. (It reminds one of the child given a pony that responds by being sad becuase than means there will be all that manure.)

It is only during this month that most forecasters have begun to show acceptance of the picture that had been foreseen here. Their predictions of unemployment rates in the 10 percent range, of the "recession" lasting until well into 1981, and of interest rates below 10 percent have all been hurriedly, and perhaps sheepishly, changed with more realistic numbers.

The forecast data here for 1981 and subsequent years has been somewhat changed. due to a change in the assumption about the proposed tax break. The estimate for the tax break has been increased from $ 30 to $ 35 billion.

KEDI has calculated the impact of three alternative tax packages. The first one is the Administration's proposal announced by President Carter calling for roughly $ 30 billion in tax reductions and cuts: approximately $ 12 billion for individuals and $ 18 billion for businesses. The second is the proposal submitted by the Congressional Joint Economic Committee (the Bentsen plan), and supported by the Financial Committee of Congress. That sought $ 22 billion in tax cuts for individuals and $ 17 billion for the business community.

The third is the revised KEDI assumption. It is anticipated that some compromise will be reached between the Carter and Bentsen plans. Here it is assumed that in 1981 there will be a tax cut of $ 20 billion for individuals and $ 15 billion for businesses. The impact of these three versions on the economy is incorporated in calculations that result in the following.

	Administration Proposal		Bentsen Plan		KEDI Assumption	
Year	1983	1985	1983	1985	1983	1985
Inflation rate, %	10.9	11.9	11.4	12.0	11.2	11.5
Productivity Increase (output per hour),%	2.9	2.1	2.8	2.1	2.6	2.0
Unemployment rate, %	6.6	7.0	6.1	6.3	6.3	6.4
Per capita disposable personal income in 1972 $, tho $	5.0	5.2	5.1	5.3	4.9	5.1

When comparing figures form the three tax cut packages, it is apparent the impact of the Bentsen plan is a bit larger than the others as it is related more to results in productivity and the standard of living. On the other hand, the inflation rate is highest here. Still, depending on your point of view, the inflation rate differences are either worth the benefits in the areas just mentioned or they are a bit too high. Again, calculations here using the various proposed combinations of tax reductions and breaks are attempts to assess the range of economic impact.

The weakest proposal, in the evaluation of this Institute, seems to be that of the Administration. It shows the lowest growth in productivity, the highest

KEDI FORECAST HIGHLIGHTS

Table 1.0

Indicator	Unit	1979	1980	1981	1985
Gross National Product	bil. const. 72 $	1431.7	1421.1	1448.6	1668.4
Index of Industrial Production	1967 =100	152.5	145.3	151.0	171.0
Capacity Utilization	%	85.7	79.4	82.4	87.1
Unemployment Rate	%	5.9	7.3	7.3	6.4
Private Housing Starts	mil. units	1.721	1.233	1.403	1.908
Car Sales	mil. units	10.8	8.3	9.8	12.1
Implicit GNP Price Deflator	1972 =100	165.5	180.7	198.4	284.7
Consumer Price Index	1967 =100	217.5	247.4	274.0	415.2
Producer Price Index	1967 =100	236.2	270.6	308.4	439.5
Federal Deficit	bil. $	-11.2	-42.9	-44.0	-18.9
Personal Income	bil. $	1924.2	2115.9	2354.6	3627.7
Prime Rate	%	12.76	14.19	12.73	11.18
Mortgage Rate	%	10.60	12.95	12.04	10.89
Currency plus Demand Deposits	bil. $	363.8	378.5	413.4	519.7
Commercial and Industrial Loans	bil. $	290.5	308.8	335.1	409.1

unemployment rate, and expected inflation rates that are viewed here has not being significantly below the expected rates associated with the other two plans. KEDI's forecast based on the assumption of a $ 35 billion tax cut is highlighted on Table 1.0 on page 4.

1.02 ASSUMPTIONS

The following assumptions are part of this forecast. Compared with assumptions incorporated into the August, 1980, issue, the changes concern the Assumptions No. 1,2, and 8, and update of Assumption No. 3.

1. In 1980, approximately 95% of the demand for oil in this country will be met. In 1981 all but basic U.S. demands for oil should be met. The weighted price of oil in 1980 will go up to the $ 34 range. In 1981, it is expected the price will go up to $ 42, in 1982, to $ 50 per barrel. in 1983, to $ 58 per barrel, in 1984, to $62 per barrel and in 1985, to $67 per barrel.

2. It is still too current to develop a longer-lasting assumption for the Iranian-Mid East crisis. Compared with the August 1980 forecast, higher price increases of energy items and substantially higher defense orders have been considered.

3. In the last months of this year, tightening of monetary policy is expected. Tight monetary policy is expected to continue throughout 1981, and some relaxation will take place not earlier than in 1982.

4. It is assumed that in 1981 the new Administration will adopt a definite program in fighting the inflation. The Federal Reserve Board will, at long last, begin a policy of setting limits to the monetary growth by long-term commitments, not just short-term as has been the policy in the past. Price and wage controls must remain the last resort of stabilization policy. For 1982 and consecutive years, we assume that the Administration will pursue a more orchestrated anti-inflation policy.

5. Our foreign trade with China will expand more rapidly starting this year, and will gain a substantial momentum in 1981 and following years.

6. In 1981 and 1982 good harvests are assumed for this country and average production of crops is expected in the U.S.S.R. A low harvest in the U.S.S.R. is expected in 1983. The U.S. 1983 harvest will be average, and the years 1984 and 1985 will bring record crops. For this year, the forecast data for some crops, mainly corn, soybeans, cotton, and some other crops will be lower than those of the last year.

7. It is projected here that the rates of growth in 1980-82 in the major industrial countries will be as follows for real GNP:

	1980	1981	1982
West Germany	2.8%	2.6%	3.0%
Italy	1.8	1.7	2.1
Japan	1.7	1.8	2.2
Great Britain	1.6	1.6	2.1
France	1.9	2.0	2.4

8. Last month the data for the forecast for 1981 and beyond were changed to include a tax cut of $ 35 billion higher than projected in the previous month. Now, we anticipate the tax cut of $ 35 billion ($20 billion for individuals, and $ 15 billion for corporations) to take effect at the beginning of 1981.

1.1 REAL GROWTH

(Table 1.10 on page 11)

Recently released data confirm the prediction made in July by KEDI that an upward trend had already started in the economy and that slow growth would follow.

Both business sales and inventories grew in July. Sales were up by 2.9 percent from the June level. Inventories rose by 0.8 percent to an adjusted $450.67 billion. The ratio of inventories to sales declined in July for the first time in six months. Business stocks equaled about 1.5 month' of sales in July. There are strong indications, that that favorable ratio has been further improved in August and September.

Some forecasters expressed the view that the inventory rise was bearish news for the economy. To them, it meant that inventories still need to be reduced and production cut back. The perspective is not shared by KEDI.(One wonders how they would have reacted as a child to a gift of a pony.)

Another change to be noted concerns unfilled orders. They did move up a smidgen in July on a seasonally adjusted basis. Such orders increased to 282.03 billion from the June level of $ 281.04. Preliminary data show further increases in August and September.

Industrial production experienced a turn-around in August. It went up to 140.5 percent of the 1967 average from the adjusted level of 139.8 in July. The 0.5 percent gain followed a decline between June and July of 1.1 percent.

Retail sales climbed by 1.5 percent in August from the July level. That was the third month in a row of gains. Total retail sales in August were 6.3 percent above the level of the year-earlier figure. Durable goods sales were down this August by 1.5 percent from the level a year ago and nondurables sales were up by 10.4 percent. That increase was led by gasoline service stations mainly due to price gains. Decreases over the year were reported by building materials, mobile home and auto dealers.

Factory shipments went up in July. This reversed the downward trend that had started here in early spring.

The Conference Board reported that its index of consumer confidence went up in August. That provided three straight months of gains.

The employment was up by a bit in August. Even though it was less than 0.1 percent, it was a gain whereas many had expected some decline in the number of people employed. The average workweek went up to 35.1 hours from the 34.9

level in July. The manufacturing workweek gained for the first time since January: it went up by 0.5 hours to 39.6.

New orders for factory goods went up in August by 0.3 percent from the July level, seasonally adjusted. There was stronger demand for steel and electrical machinery. In July, factory orders had moved ahead by 6 percent. That was the biggest jump in one month in a decade. The August increase was led by non-durables orders which went up by 1.2 percent. That more than offset the slight drop in durable orders.

Recently released figures show that the August increase in exports gave the United States the best trading month it has had in over four years. The trade deficit narrowed to $ 1.06 billion last month. Exports were up in August by 5.7 percent from the July level. There were strong gains for wheat, soybeans, non-ferrous metals and gold. Not very long ago, the Commerce department was predicting that we would have the worst trade deficit ever by the end of this year. They have now revised that to $ 34 or $ 35 billion -- down from the 1979 level of $ 37 billion. It is likely, according to calculations at KEDI that the deficit will be in the $ 32 or $33 billion range. Leading economic indicators also rose in August. Early estimate show that these indicators went up to about 131 percent of the 1967 average from the revised July level of 128.6 percent.

There are still problems. The good news mentioned needs to be tempered with the realistic evaluation that most of the gains were slight. For instance, retail sales did go up a bit, but the gain in dollar sales does not account for

the bite that inflation takes. Hence, the retailers' view of the sales as being sluggish needs to be kept in mind.

Auto sales are a continuing downer. Sales in August of domestic cars were 28 percent lower than the total for August, 1979. By mid-September, sales were off by 39 percent when compared to the year-ago period. At least, part of the decline in early September can be attributed to waiting for the introduction of the new models.

The weather has taken its toll of grains in the U.S. and Russia this year. Estimates for the size of the soybean crop and corn crop have been cut again by the Agriculture Department.

Construction spending has been going down since early this year. It did decline less sharply in July from the June level, but still the seasonally adjusted annual rate was only $214.3 billion in July whereas this rate was close to $ 250 billion before the decline began.

Overall, the data is confirming the forecast made here. Namely, that there would not be a recession (two quarters of decline in the Gross National Product in constant terms,) and that slow growth is the order of the day following the decline of the second quarter.

1.2 PRICES AND NOMINAL GNP

(Table 1.20 on page 14)

Considering the adverse effects of the weather on assorted crops and on livestock plus the increase in the assumption about the proposed tax package, the forecast here for development in prices has had to be revised upward.

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TABLE 1.10 REAL GROWTH
(Unless otherwise noted, quarterly data are seasonally adjusted at annual rates)

Indicator	Unit	1979*	1980				1980
			1*	2*	3	4	
Gross National Product, 1972 $	bil. $	1431.7	1444.7	1408.6	1411.7	1419.5	1421.1
Index of Industrial Production **	1967=100	152.5	152.2	144.6	140.9	143.6	145.3
Unemployment Rate	%	5.9	6.1	7.5	7.6	7.8	7.3
Capacity Utilization Rate	%	85.7	85.1	77.0	76.6	78.7	79.4
Private Housing Starts	mil. units	1.721	1.330	1.048	1.263	1.290	1.233
Car Sales	mil. units	10.8	9.5	7.7	7.9	8.1	8.3

Indicator	Unit	1980	1981				1981
			1	2	3	4	
Gross National Product, 1972 $	bil. $	1421.1	1427.8	1440.5	1455.7	1470.3	1448.6
Index of Industrial Production	1967=100	145.3	147.7	149.8	151.5	155.1	151.0
Unemployment Rate	%	7.3	7.6	7.4	7.1	6.9	7.3
Capacity Utilization Rate	%	79.4	79.4	81.3	84.2	84.5	82.4
Private Housing Starts	mil. units	1.233	1.161	1.358	1.549	1.540	1.403
Car Sales	mil. units	8.3	8.6	9.6	10.2	10.6	9.8

Indicator	Unit	1981	1982				1982
			1	2	3	4	
Gross National Product, 1972 $	bil. $	1448.6	1482.5	1500.4	1529.7	1529.8	1508.2
Index of Industrial Production	1967=100	151.0	158.8	161.2	163.4	165.4	162.2
Unemployment Rate	%	7.3	6.8	6.4	6.2	6.2	6.4
Capacity Utilization Rate	%	82.4	85.6	86.0	86.3	86.5	86.1
Private Housing Starts	mil. units	1.403	1.426	1.634	1.685	1.720	1.617
Car Sales	mil. units	9.7	10.3	10.9	10.8	11.3	10.8

* Historical Data

** Historical Data: Revised by the Federal Reserve, September 1979.

However, when compared to the figures in earlier forecasts, the changes are not too large. The long-term outlook for prices according to KEDI is as follows:

	1980	1981	1982	1983	1984	1985
Consumer Price Index	247.3	274.0	308.2	340.6	375.4	418.5
% change from prior year	13.7	10.8	12.4	10.6	10.2	11.5

As can be seen from this table, the inflation rate is not expected to drop below 10 percent in the next five years.

Food prices will add extra points to the inflation rate, (accounted for in the calculations here). The rise in food prices begins with the bad weather which has led to large losses in the size of the estimated harvests for corn, soybeans, spring wheat, hay, oats, barley and sorghum. Prices for corn, a major livestock feed and oil source, have risen over 25 percent since June. (Such gains do not match the loss farmers have been experiencing.)

Prices for hogs are expected to go up at a faster rate than the Agriculture Department had forecast earlier. One of the factors is the higher cost for feed. Another factor is the time-worn cycle of production. As prices dropped a bit early this year, farmers began to lose money and cut supplies, and now that prices are starting back up, it is likely that supplies will gradually increase until that translate into lower gains, et cetera.

Consumer prices as measured by the Consumer Price Index slowed their rate of gain during July and August. Unfortunately, this is only a temporary aberration. Contributing to it was the short drop in mortgage rates early in the summer. Interest rates have been moving up again and mortgage rates will follow.

The Producer Price Index went up a seasonally adjusted 1.5 percent in August. That would yield an annual inflation rate of over 20 percent for such prices. In July that Index was up by 1.7 percent. Most of the gain in these two months was attributed to the increases in food prices which will continue to rise. KEDI agrees with Sylvia Porter's estimate that overall food prices will be up about eight or nine percent this year and over 10 percent next year.

1.3 EMPLOYMENT AND LABOR

(Table 1.30 on page 16)

In this issue, the forecast for the unemployment rate has been lowered for the third quarter. This is due largely to the widely unexpected drop in the unemployment rate in August to 7.6 from the 7.8 rate in July. The data for unemployment in the fourth quarter of this year and the following quarters have remained basically unchanged.

For the year 1981 and following years, the projection here remains optimistic. It is expected that the unemployment rate has already peaked. Gradual

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TABLE 1.20 PRICES AND NOMINAL GNP
(Unless otherwise noted, quarterly data are seasonally adjusted at annual rates)

Indicator	Unit	1979*	1980				1980
			1*	2*	3	4	
Consumer Price Index, NSA	1967=100	217.5	236.6	245.0	251.0	257.0	247.4
Producer Price Index, NSA	1967=100	236.2	258.7	263.7	274.0	285.8	270.6
Implicit GNP Price Deflator	1972=100	165.5	174.5	179.0	182.6	186.7	180.7
Gross National Product	bil. $	2369.5	2520.8	2521.3	2577.9	2650.5	2567.7
Personal Consumption Expenditures	bil. $	1510.0	1629.5	1626.6	1665.8	1698.7	1655.2
Gross Private Dom. Investment	bil. $	387.3	387.7	368.5	380.2	395.6	383.0

Indicator	Unit	1980	1981				1981
			1	2	3	4	
Consumer Price Index, NSA	1967=100	247.4	261.9	265.7	280.4	287.8	274.0
Producer Price Index, NSA	1967=100	270.6	294.3	305.7	312.8	320.6	308.4
Implicit GNP Price Deflator	1972=100	180.7	190.4	195.2	201.0	206.4	198.4
Gross National Product	bil. $	2567.7	2718.5	2811.9	2926.0	3048.6	2876.3
Personal Consumption Expenditures	bil. $	1655.2	1753.1	1820.4	1922.5	1970.9	1866.7
Gross Private Dom. Investment	bil. $	383.0	402.4	420.5	432.7	449.5	426.3

Indicator	Unit	1981	1982				1982
			1	2	3	4	
Consumer Price Index, NSA	1967=100	247.0	294.9	306.5	312.8	318.6	308.2
Producer Price Index, NSA	1967=100	308.4	331.4	339.2	347.6	354.3	343.1
Implicit GNP Price Deflator	1972=100	198.4	208.3	212.5	216.6	220.8	214.6
Gross National Product	bil. $	2876.3	3088.0	3188.4	3291.7	3378.7	3236.7
Personal Consumption Expenditures	bil. $	1866.7	2014.5	2070.5	2145.6	2192.8	2105.9
Gross Private Dom. Investment	bil. $	426.3	461.3	476.9	496.5	517.3	470.5

* Historical Data

decline will occur from now on (see Table 1.30 on page 16).

KEDI projections for the unemployment rate in 1980 have been constantly close to the actual developments. For instance, indications now point to a third quarter unemployment rate that will be close to 7.6 percent.

Data released this month on umemployment by states shows the impact of the automobile industry. For the fifth month in a row, Michigan had the highest unemployment of any state: 14.1 percent in July. Unemployment in both Indiana and Alabama was a bit above 11 percent. In Ohio and Illinois, the figures were near 10 percent.

By industry, unemployment in August and early data for September showed improvement in manufacturing where the rate dropped from above 10 percent to 9.3. However, in construction, the rate increased again to 18.3 from 16.1 percent.

1.4 HOUSING

(Table 1.40 on page 18)

The forecast for housing starts have been increased slightly. It is expected here that the present gains in mortgage rate will not continue for long. This is in opposition to the view of some forecasters that see the rate gains as a sign of more increases to come and the consumer being "choked" out of buying a house. KEDI expects that the impact of the present high mortgage rates on the number of housing starts will be insignificant.

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TABLE 1.30 EMPLOYMENT AND LABOR
(Quarterly data are seasonally adjusted at annual rates)

Indicator	Unit	1979*	1980				1980
			1*	2*	3	4	
Population	mil.	220.4	221.9	222.6	223.4	224.1	223.0
Civilian Labor Force	mil.	103.3	104.2	104.7	105.2	106.0	105.0
Employed	mil.	97.2	97.8	96.9	97.2	97.7	97.4
- Agriculture	mil.	3.3	3.3	3.4	3.4	3.3	3.4
- Non Agriculture	mil.	93.9	94.5	93.5	93.8	94.4	94.0
Unemployment Rate	%	5.80	6.13	7.46	7.65	7.83	7.27

Indicator	Unit	1980	1981				1981
			1	2	3	4	
Population	mil.	223.0	224.7	225.5	226.3	227.1	225.9
Civilian Labor Force	mil.	105.0	106.6	107.0	107.8	108.5	107.5
Employed	mil.	97.4	98.5	99.0	100.1	101.0	99.7
- Agriculture	mil.	3.4	3.3	3.3	3.4	3.3	3.3
- Non Agriculture	mil.	94.0	95.2	95.7	96.7	97.7	96.4
Unemployment Rate	%	7.27	7.64	7.43	7.11	6.92	7.28

Indicator	Unit	1981	1982				1982
			1	2	3	4	
Population	mil.	225.9	228.0	229.2	230.4	231.3	229.7
Civilian Labor Force	mil.	107.5	109.1	109.9	110.7	111.6	110.3
Employed	mil.	99.7	101.6	102.8	103.8	104.7	103.2
- Agriculture	mil.	3.3	3.3	3.4	3.4	3.3	3.4
- Non Agriculture	mil.	96.4	98.3	99.4	100.4	101.4	99.8
Unemployment Rate	%	7.28	6.85	6.44	6.24	6.18	6.43

* Historical Data

Moreover, the peak in such rates will be reached in the fourth quarter. After that, gradual declines will take place.

Still, 1981 is not viewed very favorably in terms of housing. KEDI does not anticipate any vigorous growth in housing starts before 1982.

Mobile home shipments will remain sluggish during both 1981 and 1982. Some recovery will begin to occur in 1983.

In August, housing starts rose by 12 percent to reach a seasonally adjusted annual rate of 1.39 million. That was the third month of gains. However such starts in August were still 21.8 percent lower than August of 1979.

Building permits went up by 7.8 percent in August. Again, that is three months of gains. Permits had gone up by 14.7 percent in July.

1.5 GOVERNMENT BUDGETS

(Table 1.50 on page 23)

The projection of budget indicators presented here is based on the assumption of a $35 billion tax cut in 1981. This was discussed in the Overview section and is Assumption No. 8.

The projection of the federal deficit presented here (see Table 1.50) shows the deficit remaining on a fairly high level in 1981 and somewhat exceeding the 1980 deficit. Starting in 1982, a decline in the deficit will begin and will reach the lowest level, roughly $ 17 billion, in 1984. In

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TABLE 1.40 HOUSING
(Quarterly data are seasonally adjusted at annual rates)

Indicator	Unit	1979*	1980				1980
			1*	2*	3	4	
Single-Family Housing Starts	mil.	1.169	.801	.669	.789	.776	.759
Multifamily Housing Starts	mil.	.551	.529	.379	.474	.514	.474
Mobile Home Shipments	mil.	.283	.257	.180	.183	.194	.204
Housing Permits Issued	mil.	1.535	.965	.885	1.043	1.002	.974
Construction Costs-Commerc.	1972=100	180.2	193.5	197.0	198.9	201.3	197.7
Construction Costs-Resident.	1972=100	178.8	192.1	196.4	198.5	203.4	197.6

Indicator	Unit	1980	1981				1981
			1	2	3	4	
Single-Family Housing Starts	mil.	.759	.740	.802	.956	.948	.862
Multifamily Housing Starts	mil.	..474	.421	.556	.593	.592	.541
Mobile Homes Shipments	mil.	.204	.214	.256	.267	.279	.254
Housing Permits Issued	mil.	.974	.995	1.214	1.395	1.406	1.253
Construction Costs-Commerc.	1972=100	197.7	207.8	214.9	218.0	228.3	217.3
Construction Costs-Resident.	1972=100	197.6	209.0	213.8	218.7	229.0	217.6

Indicator	Unit	1981	1982				1982
			1	2	3	4	
Single-Family Housing Starts	mil.	.862	.866	.991	1.046	1.063	.992
Multifamily Housing Starts	mil.	.541	.560	.643	.639	.657	.625
Mobile Homes Shipments	mil.	.254	.268	.304	.314	.303	.297
Housing Permits Issued	mil.	1.253	1.315	1.667	1.759	1.716	1.614
Construction Costs-Commerc.	1972=100	217.3	238.0	249.3	255.0	263.9	251.6
Construction Costs-Resident.	1972=100	217.6	239.4	251.0	256.8	266.3	253.4

* Historical Data

1985, it is expected, that the deficit will go up again. The estimate by KEDI for that year is approximately $ 18.9 billion. In other words, in the 1981-85 time period, the federal budget cannot move from the red ink to black. (Politicians better not promise to deliver a balanced budget if they value whatever degree of credibility they do have.)

As compared with our previous forecast, no substantial changes in the projection of the federal deficit was made for 1981 or the first one-half of 1982. It will take time for the effects of the tax package to be felt. Starting in the latter part of 1982 and through 1984, the deficits are lower than what had been expected here prior to this issue. That is because it is anticipated that the higher tax custs ($ 35 billion as compared with the previously assumed $ 30 billion) will start to show their impact more fully then because the tax cuts for businesses will result in gradual higher productivity, and this will lead to higher receipts in taxes.

Regarding the state and local budgets, there have been some changes in the forecast here. The estimates for surpluses have been slightly reduced from what they were in the previous forecast.

1.6 INCOME

(Table 1.60 on page 23)

The forecast data for personal income and personal disposable income have been slightly increased due to the change in Assumption No. 8 about the

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TABLE 1.50 FEDERAL AND STATE
AND LOCAL BUDGETS
(Quarterly data are seasonally adjusted at annual rates)

Indicator	Unit	1979*	1980				1980
			1*	2*	3	4	
Federal Govt.: Income Taxes	bil. $	225.0	239.9	242.9	243.1	250.7	244.2
Corporate Profit Tax Accruals	bil. $	78.5	86.8	65.6	70.1	75.9	74.6
Surplus./Deficit	bil. $	-11.2	-22.9	-49.2	-54.1	-45.4	-42.9
State and Local Governments: Income Taxes	bil. $	40.7	39.7	39.2	39.7	41.0	39.9
Corporate Profit Tax Accruals	bil. $	14.4	15.6	12.0	12.1	12.8	13.1
Surplus./Deficit	bil. $	24.7	24.6	19.5	19.6	20.1	21.0

Indicator	Unit	1980	1981				1981
			1	2	3	4	
Federal Govt.: Income Taxes	bil. $	244.2	265.4	283.6	298.7	312.2	290.0
Corporate Profit Tax Accruals	bil. $	74.6	80.4	96.7	100.4	104.9	95.6
Surplus./Deficit	bil. $	-42.9	-41.1	-46.5	-47.3	-41.2	-44.0
State and Local Governments: Income Taxes	bil. $	39.9	42.6	44.7	46.1	47.5	45.2
Corporate Profit Tax Accruals	bil. $	13.1	14.0	15.2	17.0	18.7	16.2
Surplus./Deficit	bil. $	21.0	21.0	23.1	24.8	26.3	23.8

Indicator	Unit	1981	1982				1982
			1	2	3	4	
Federal Govt.: Income Taxes	bil. $	290.0	323.4	334.6	343.8	350.2	338.0
Corporate Profit Tax Accruals	bil. $	95.6	110.2	117.4	122.8	126.2	119.2
Surplus./Deficit	bil. $	-44.0	-35.1	-29.6	-23.2	-19.8	-26.9
State and Local Governments: Income Taxes	bil. $	45.2	49.8	51.1	52.9	54.8	52.2
Corporate Profit Tax Accruals	bil. $	16.2	22.0	24.1	25.8	28.1	25.0
Surplus./Deficit	bil. $	23.8	27.3	28.9	30.4	31.8	29.6

* Historical Data

increased tax break and a slightly more optimistic projection of employment than had been seen in the previous issue. See Section 1.3 Employment and Labor.) It is not expected that there will be any significant improvements until at least 1983.

Although these numbers are more favorable than they had been in the last issue of this publication, the outlook remains quite cloudy -- especially when the real bite that inflation takes out of earnings is considered. There will be no real improvement in average income in the 1981-85 period.

Take as an example the average weekly earnings as reported here in Table 1.60. Deflated by the Consumer Price Index, it can be seen that the purchasing power of earnings will be constantly eroded by inflation. Average weekly earnings in 1967 dollars came to $ 100.8 in 1979. The projection here for the current year and the next five years in 1967 dollars, is as follows:

1980, $94.6;
1981, $93.1;
1982, $92.9;
1983, $93.9;
1984, $94.7;
1985, $97.3.

Such figures show how inflation hits.

Although the Consumer Price Index is not a fully ideal measure of the costs of living, it is obvious that the purchasing power will be at best, somewhat stabilized with little improvement in sight. (Seeing books in bookstores

about how to buy wisely and stretch dollars points to the impact of the problem, but how many really like powdered milk, lots of peanut butter and coupon clipping.)

The projected data for corporate profits have been increased. Again, the main reason has to do with the change in the tax break assumption.

1.7 MONEY AND CREDIT

(Table 1.70 on page 25)

This month's forecast differs from the previous one in two areas:

1. The data for the money supply, M1A and M2 are higher here, due mainly to the anticipated rate of inflation begin somewhat higher than had been calculated in the August issue.

2. The projections for consumer installment credit, and commercial and industrial loans has somewhat been increased.

It has been anticipated by KEDI for many months that monetary policy would tighten in the last months of this year because the recovery from the summer slump will stimulate higher demand for money and will increase the inflationary pressure. That is now becoming a reality. Some economists foresee, NOW, (they did not do so earlier) that tighter Federal Reserve policy will be realized. For instance, in late September, the Wall Street Journal mentioned economists with securities firms expressing the view that it is now likely the Federal Reserve will act to tighten credit and slow money growth as a result. Another indicated that growth in the money supply that has

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TABLE 1.60 INCOME
(Quarterly data are seasonally adjusted at annual rates)

Indicator	Unit	1979*	1980				1980
			1*	2*	3	4	
Personal Income	bil. $	1924.2	2057.4	2080.5	2138.4	2187.3	2115.9
Personal Dispos. Income	bil. $	1624.1	1737.4	1755.9	1789.5	1832.9	1787.9
Compensation of Employees	bil. $	1459.5	1555.2	1564.2	1596.4	1651.4	1591.8
Corp. Profits After Tax	bil. $	144.6	158.0	127.1	130.9	137.3	138.3
Personal Saving	bil. $	73.2	64.4	86.3	90.2	97.2	84.5
Average Weekly Earnings	$	219.4	229.2	231.2	233.5	235.4	232.3

Indicator	Unit	1980	1981				1981
			1	2	3	4	
Personal Income	bil. $	2115.9	2224.3	2296.4	2412.5	2485.3	2354.6
Personal Dispos. Income	bil. $	1787.9	1879.9	1938.2	2038.7	1930.7	1989.9
Compensation of Employees	bil. $	1591.8	1708.1	1759.6	1862.1	1930.7	1815.1
Corp. Profits After Tax	bil. $	138.3	146.7	155.0	171.7	177.0	162.6
Personal Saving	bil. $	84.5	98.3	94.7	90.4	96.2	94.9
Average Weekly Earnings	$	232.3	238.9	242.6	245.8	249.8	244.3

Indicator	Unit	1981	1982				1982
			1	2	3	4	
Personal Income	bil. $	2354.6	2518.3	2603.6	2685.6	2741.5	2637.3
Personal Dispos. Income	bil. $	1989.9	2121.4	2192.4	2262.6	2316.9	2223.4
Compensation of Employees	bil. $	1815.1	1956.4	2034.7	2102.5	2178.7	2068.1
Corp. Profits After Tax	bil. $	162.6	181.3	185.3	190.7	191.5	187.2
Personal Saving	bil. $	94.9	96.3	98.7	100.2	101.4	99.2
Average Weekly Earnings	$	244.3	254.6	259.7	265.1	270.7	262.5

* Historical Data

taken place recently puts pressure of the Fed to restrain credit. (Such views are old news to KEDI.)

The position of KEDI remains unchanged: the Federal Reserve will tighten the credit and money supply BUT IN A MODERATE WAY. That is, there will be no dramatic squeezes. They have (at last) learned from the steps were taken on October 6, 1979 and March 14, 1980 and the economy weakening results. It is predicted ere that in 1981 the money supply will gain by 9.3 percent compared to 1980, and in 1982 the growth will be about 9.5 percent. That is fast, but not really an inflationary growth. The assumption is maintained that the Federal policy will remain restrictive through 1983. Some relaxation may take place in 1984.

1.8 INTEREST RATES, YIELDS AND SECURITY PRICES

(Table 1.80 on page 28)

The recent developments in interest rates confirm the predictions made here in the spring that interest rates would go up in the last months of this year. In late September the Federal Reserve increased its discount rate to 11 percent from 10 percent. That was the first gain since mid-February when it was hiked to a record 13 percent. That rate was last reduced in late July to 10 percent.

This Institute expects that the prime rate will peak at about 14 percent in the coming quarter (October-December). After that, it will drop slightly.

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TABLE 1.70 MONEY AND CREDIT
(Data for "Currency + Demand Deposits" and "Time Deposits, Adjusted" are averages of daily figures; other data are end of period figures)

Indicator	Unit	1979*	1980				1980
			1*	2 *	3	4	
Currency + Demand Deposits, M1A	bil. $	363.8	374.8	368.9	380.2	390.1	378.5
Time Deposits, Adjusted, M2	bil. $	1471.4	1543.6	1565.8	1602.1	1619.7	1582.8
Consumer Instal. Credit	bil. $	311.1	307.6	301.4	302.8	307.1	307.1
Commerc. and Industr. Loans at Banks	bil. $	290.5	302.7	301.7	303.7	308.8	308.8
Negotiable Cert. of Deposits	bil. $	115.6	117.2	121.4	122.4	126.9	126.9
Mortgages at S & L Assns.	bil. $	475.8	479.3	479.1	480.5	485.1	485.1
Indicator	Unit	1980	1981				1981
			1*	2 *	3	4	
Currency + Demand Deposits, M1A	bil. $	378.5	397.4	410.6	418.9	426.5	413.4
Time Deposits, Adjusted, M2	bil. $	1582.8	1680.7	1721.3	1746.8	1773.4	1730.5
Consumer Instal. Credit	bil. $	307.1	312.6	318.6	321.4	327.3	327.3
Commerc. and Industr. Loans at Banks	bil. $	308.8	314.8	320.1	328.6	335.4	335.1
Negotiable Cert. of Deposits	bil. $	126.9	130.7	133.4	139.2	146.7	146.7
Mortgages at S & L Assns.	bil. $	485.1	490.5	496.3	502.3	514.7	514.7
Indicator	Unit	1981	1982				1982
			1*	2 *	3	4	
Currency + Demand Deposits, M1A	bil. $	413.4	432.4	440.5	448.2	455.4	444.6
Time Deposits, Adjusted, M2	bil. $	1730.5	1802.5	1846.8	1893.2	1929.7	1868.1
Consumer Instal. Credit	bil. $	327.3	335.6	343.4	350.6	359.7	359.7
Commerc. and Industr. Loans at Banks	bil. $	335.1	340.2	346.8	354.5	359.4	359.4
Negotiable Cert. of Deposits	bil. $	146.7	151.2	156.7	159.4	164.3	164.3
Mortgages at S & L Assns.	bil. $	514.7	526.8	534.4	541.4	554.8	554.8

* Historical Data

Since 1979, KEDI has been forecasting within a framework of high U.S. interest rates. The long-term projection shows that the prime rate will be close to the 10 percent range no earlier than 1984. After that, it will go up again.

KEDI and a small minority of other forecasters maintained the position in August of this year that interest rates would not go down any more. The majority of forecasters were overly cheerful in predicting that the prime rate would be below 10 percent in September and October of this year.

As this Institute views the situation, there are two main reasons why interest rates cannot go down. First, when the recovery really starts from the downturn, the higher demand for funds necessarily puts pressure on interest rates. Secondly, over the long-term, there cannot be a wide and artificial gap between the low rates in this country and the high rates abroad. At the present time, the overseas' prime rates or their equivalents are around 16 percent. A U.S. prime rate in the 10-11 percent range could not stand for very long since that would lead to the deterioration of the international value of the dollar and to subsequent gains in the price level. That is, it would act as an added factor to inflation as the ripple effect spreads.

Over the long-term, it is the view here that other countries will not be willing to decrease their interest rates as they are deeply involved in the fight against inflation. Also, the economy here will be under inflationary

pressure continuously. Hence, high interest rates will persist for many years. The sunny photo of cheap credit taken by many overly optimistic economists simply will not be developed.

The KEDI view of high rates as begin here to stay is only now beginning to be shared by most analysts. Whereas many of them were anticipating interest rate drops before this year ended and rates remaining on the low side, more of them are just now making public statements about high rates next year.

2.0 COMPARISONS OF ACCURACY OF PREDICTIONS

In this issue, Consumer Price Index for the second quarter 1980 has been selected for comparison. Actual figures have been computed as the three-month average of April-June 1980 data published in the Survey of Current Business, Blue pages, July 1980. Forecast data is from Business Forecasts 1980, published by the Federal Reserve Bank of Richmond, Va., February, 1980, Library of Congress Catalogue Card No: 75-189493. The table below shows the predictions of forecasters and the deviations of forecast data.

Table 2.0 COMPARISONS OF ACCURACY OF PREDICTIONS

CONSUMER PRICE INDEX
(1967 = 100.)

Actual: 245.0

FORECASTER	Page in Business Forecasts 1980	Forecast	% of Accuracy
Manufacturers Hanover Trust	20	235.5	-3.8

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TABLE 1.80 INTEREST RATES, YIELDS AND SECURITIES PRICES

Indicator	Unit	1979*	1980				1980
			1*	2*	3	4	
3 mo Treas. Bills Rate (new issues)	%	10.19	13.35	9.97	19.76	11.28	11.34
Prime Rate	%	12.76	16.39	15.74	11.36	12.27	14.19
Mortgage Rate, New Homes	%	10.60	15.23	12.27	11.73	12.58	12.95
Aaa Bonds Rate	%	9.63	12.14	11.05	10.72	11.13	11.29
Long Term Govt. Bonds Yield	%	9.33	11.78	10.71	10.24	10.56	10.82
Standard & Poor's 500 Average	1941-43 =10	102.83	110.30	108.40	104.16	102.89	106.43

Indicator	Unit	1980	1981				1981
			1	2	3	4	
3 mo Treas. Bills Rate (new issues)	%	11.34	11.89	11.75	11.70	10.85	11.55
Prime Rate	%	14.19	13.06	12.63	11.92	11.85	12.37
Mortgage Rate, New Homes	%	12.95	12.64	12.10	11.83	11.57	12.04
Aaa Bonds Rate	%	11.29	11.03	10.96	10.73	10.78	10.89
Long Term Govt. Bonds Yield	%	10.82	10.74	10.96	10.63	10.41	10.69
Standard & Poor's 500 Average	1941-43 =10	106.43	102.06	103.24	105.14	106.28	104.18

Indicator	Unit	1981	1982				1982
			1	2	3	4	
3 mo Treas. Bills Rate (new issues)	%	11.55	10.72	11.16	11.87	11.96	11.43
Prime Rate	%	12.37	11.90	12.04	12.17	12.48	12.15
Mortgage Rate, New Homes	%	12.04	11.50	11.14	11.04	10.95	11.16
Aaa Bonds Rate	%	10.89	10.89	11.04	11.53	11.87	11.33
Long Term Govt. Bonds Yield	%	10.69	10.36	10.48	10.65	10.78	10.57
Standard & Poor's 500 Average	1941-43 =10	104.18	107.14	103.25	101.64	100.06	103.02

* Historical Data

Table 2.0 cont.)

FORECASTER	Page in Business Forecasts 1980	Forecast	% of Accuracy
Chemical Bank	21	238.5	-2.7
The First National Bank of Chicago	22	239.4	-2.3
Georgia State University	24	240.2	-2.0
Bankers Trust Company	28	240.3	-2.0
Goldman Sachs	29	241.4	-1.5
KEDI	31	240.3	-2.0
Morgan Guaranty Trust Company	35	241.5	-1.5